

**TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING # 97-63**

WARNING

Revenue rulings are not binding on the Department. This presentation of the ruling in a redacted form is information only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Departmental policy.

SUBJECT

Application of franchise, excise tax to limited liability company.

SCOPE

Revenue rulings are statements regarding the substantive application of law and statements of procedure that affect the rights and duties of taxpayers and other members of the public. Revenue rulings are advisory in nature and are not binding on the Department.

FACTS

Corporation A is incorporated under the laws of Delaware and is commercially domiciled in [STATE X - NOT TENNESSEE]. Corporation A has entered into a definitive agreement to purchase the assets of a retail business in Tennessee. Corporation A will create a wholly owned subsidiary ("Newco A") that will be incorporated and domiciled in Tennessee. To capitalize this subsidiary, Corporation A will contribute 1% of the purchase price of the retail business to Newco A in exchange for 100% of the subsidiary's stock. Simultaneously, Corporation A will contribute the remaining 99% of the purchase price to a newly formed subsidiary ("Newco B") incorporated and domiciled in [STATE Y -NOT TENNESSEE] in exchange for 100% of the entity's stock. Newco B will not obtain a Certificate of Authority to transact business or conduct affairs in Tennessee.

Immediately following the capitalization of the wholly-owned subsidiaries, Newco A and Newco B will contribute cash to a limited liability company in exchange for membership interests. The LLC's operating agreement will provide the rules for conducting the affairs of the LLC and its relationship with its members. The LLC will be board managed. Newco A will receive a 1% interest and as a member manager, will have the power to elect all three members of the board of governors. Newco B will receive a 99% membership interest and will not have the power to elect any persons to the board of governors. Newco B will exercise no power, management or control over the LLC except such powers or

capacities analogous to those outlined in Tenn. Code Ann. § 61-2-302, that a limited partner may exercise without participating in the management or control of a partnership. The LLC will in turn purchase the assets of the retail business. For federal tax purposes, the LLC will be treated as a partnership through its not electing to be taxed as a corporation pursuant to Treasury Reg. § 301.7701-3.

ISSUES

1. Whether the LLC is subject to Tennessee corporate franchise, excise taxes.
2. Whether Newco B's membership interest in the LLC creates sufficient nexus in Tennessee to subject Newco B to Tennessee corporate franchise, excise tax.

RULINGS

1. The LLC is not subject to Tennessee corporate franchise, excise taxes.
2. Newco B's membership interest in the LLC does not create sufficient nexus to subject Newco B to Tennessee corporate franchise, excise tax.

ANALYSIS

1. Tenn. Code Ann. § 48-211-101 provides that, for purposes of all Tennessee state and local taxes, an LLC will be treated as a partnership if it is so classified for federal income tax purposes. Tennessee franchise, excise taxes do not apply to partnerships and Tennessee has no general income tax. Tenn. Code Ann. §§ 67-4-806(a) and 67-4-903(a) list entities that are subject to Tennessee franchise, excise taxes as “[a]ll corporations, cooperatives, joint-stock associations and business trusts, including regulated investment companies and real estate investment trusts . . . including state chartered banks and national banks . . . and . . . state chartered savings and loan associations and federally chartered savings and loan associations doing business in Tennessee.”

For federal tax purposes, the LLC formed by Newco A and Newco B will be treated as a partnership through its not electing to be taxed as a corporation. Accordingly, the LLC is not subject to Tennessee franchise, excise tax.

2. Tenn. Code Ann. § 48-211-101 states that the members of a foreign LLC treated as a partnership for federal income tax purposes are subject to all state and local Tennessee taxes in the same manner and extent as partners in a foreign partnership.

For many years the Department of Revenue has taken the position that a foreign corporate limited partner whose only Tennessee activity is the holding of a limited partnership interest is not doing business so as to be subject to Tennessee corporate franchise/excise taxes. A limited partner has no right to participate in partnership management and has not been determined to be “doing business” as a result of this activity. A foreign corporate limited partner's involvement in a Tennessee partnership appears to be similar to the interest of a foreign corporation whose only Tennessee activity is that of a stockholder in a Tennessee corporation. Neither has the right to participate in the management

or control of the partnership, or corporation, as the case may be, and thus neither are said to be “doing business” in Tennessee in corporate form so as to be subject to the Tennessee corporate franchise/excise tax imposed by Tenn. Code Ann. §§ 67-4-901 et seq. and 67-4-801 et seq. Like the foreign corporate stockholder, this policy dictates that the foreign corporate limited partner only has a passive investment in Tennessee which fails to create sufficient tax nexus for Tennessee corporation franchise/excise tax purposes.

This same rationale would apply to a foreign corporate member of a board-governed LLC. The corporation would not be subject to Tennessee franchise/excise taxes as long as it, (1) has no other business activities in Tennessee; (2) is not a board member of the LLC; (3) is not an appointed, elected, or considered elected chief manager, manager, secretary or agent of the LLC under Tenn. Code Ann. §§ 48-241-103 through 48-241-106, and (4) exercises no power, management, or control over the LLC under Tenn. Code Ann. § 48-238-101(a)(3) of the Tennessee Limited Liability Company Act except such powers or capacities similar to those outlined in Tenn. Code Ann. § 61-2-302 that a limited partner may exercise without participating in management or control of a partnership.

As long as the activities of the foreign corporate member of the board-managed LLC do not exceed the criteria set forth above, its LLC member status would not, in and of itself, subject it to Tennessee corporate franchise/excise taxes. However, it would be possible for the foreign corporate member to engage in other transactions, either with the LLC itself, or with other parties, that would result in sufficient Tennessee minimum contacts to subject it to such taxes.

The department's long-standing policy of not subjecting a foreign corporate limited partner to Tennessee corporate franchise/excise taxes imposed by Tenn. Code Ann. §§ 67-4-901 et seq. and 67-4-801 et seq. serves as a guide to treat a foreign LLC member similarly. Long-standing administrative interpretations and applications of statutes are accorded persuasive weight by the courts and will usually be followed unless palpably erroneous. *Gallagher v. Butler*, 378 S.W.2d 161,166 (Tenn. 1964). Since the Department's policy with regard to limited partnerships is presumed to be a correct interpretation, application of the same logic to the analogous circumstances of a foreign corporation with a passive investment in a board-managed LLC is appropriate.

Newco B will not have the power to elect any persons to the board of governors of the LLC and will exercise no power, management or control over the LLC except such powers or capacities analogous to those outlined in Tenn. Code Ann. § 61-2-302 that do not involve participation in management or control of the LLC. Accordingly, Newco B will not be subject to Tennessee franchise, excise taxes.

Caroline R. Krivacka
Tax Counsel

APPROVED: _____
Ruth E. Johnson
Commissioner

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